

## Introduction to Corporations

### Key business structures

- Sole Trader
- Partnership
- Company
- ~~Joint Venture~~
- ~~Trading Trust~~

### Issues to consider in choosing a business structure over another – deciding the legal structure of rules that will apply to your business

- Who is going to be part of the day to day management of the business?
- How many people are likely to be involved and in what capacities?
- How long do you want the business to last for?
- Do you want to later sell the business?
- How do you want to deal with profit and loss sharing?
- What degree of external regulation do you want?
- What are your main/future sources of finance?

### Sole trader/ sole proprietor

- **Not** a form of business association
  - Not a legal structure and not creating anything separate from yourself
- But many businesses are run by individuals – if you choose to be a sole proprietor you can register a business name and operate under that name, but nothing is separate from you and you bear all the rights and responsibilities for that business
- Can only operate if there is ONLY one person running the business
  - As soon as there is more than one person, there is either a partnership or a company
  - Once an entrepreneur decides not to do it alone, several possibilities present themselves – joint venture, trading trust, partnership or company, either alone or in groups.

### Advantages and disadvantages

- a small degree of external regulation
  - Free to run the business as they want to, and don't have anyone telling you what to do
- higher potential for significant outsiders to impose constraints (eg banks)
  - Negative: Banks usually like the formal structure of a partnership or a company, not sole traders, so they will usually want greater security or else it would be harder to lend you money
- full personal liability for any debts of business unless minimised contractually or by asset divestment
  - Regardless of whether the debts are incurred in your name or the name of the business you registered
  - If you cannot pay the debts as a sole trader, your own personal assets will be used or you can become bankrupt
  - Note: You can register a business name as a sole trader, that does not create any legal entity or liability for that business, the individual in law is still liable for all the business debts
- ease and simplicity of establishment and running
  - don't have to do anything to set it up
- harder to attract outside funds
- flexibility
- limited scope for significant expansion
- few specific legal constraints
- few income tax advantages
  - Don't have to pay provisional tax

### Partnership

- Exists as soon as there is more than one person running the business, regardless of whether they intended it to exist or not
  - Each Act contains the same legal definition of a partnership [s.6 ACT Act]: *the relation which exists between persons carrying on business in common with a view of profit.*
    - Persons – more than one individual, includes any legally recognised person (including a company)
    - Carrying on a business – or any trade, occupation, profession, etc.

- View to profit – distinguishes partnerships from social and non-profit organisations, who won't be a partnership under the Act
      - There is still debate over whether it is necessary for all partners to participate to some extent in a share of the profits
  - It applies automatically
  - Governed by law of contract and the Partnership Acts
    - No legal structure involved – it simply implies a contractual relationship between the parties involved
    - The Partnership Act is essentially a contractual relationship which has standard terms to determine the rights and responsibilities between the parties, as well as to outsiders (creditors)
- Oldest form of business association – flexible legal business arrangement, but had standardised rules that applied
  - Agreements on how to run the business – how to contribute to profits and capital, how to split losses, etc.
  - Essentially, a partnership is a contractual agreement between two or more persons in which each partner acts as an agent for each other partner **ie each partner is at the same time an agent for and a principal of each other partner.**
  - All partnerships are governed by the *Partnership Act* which is found in each State and Territory (all these Acts are based on the English Partnership Act of 1890).
    - Law of partnership has essentially not changed since it was inherited from the UK in 1980, and contain very few rules
- Standardised or default rules contained in the Partnership Acts which apply automatically to partnerships, but all can be contracted out of
  - Includes things like: liability section (?)
    - You could write a contract saying that each of the partners must set up a company and make those companies become the partners, so there is limited liability
  - Contracted out of by making their own rules so that the standardised rules in the act don't apply at all (since the law implies a contractual relationship)
  - As between the partners themselves, the Act generally leaves it to them to define their own internal allocation of responsibilities and liabilities
    - E.g. how much capital a partner puts in, what % of the profits they receive, how to leave the partnership, how to resolve disputes
- Generally, no formal requirements for creation of a partnership
  - It can be in writing, or verbal, or inferred from conduct.
- A partnership does not have a legal entity
  - Thus, each partner has **unlimited personal liability** to third parties for the debts of the partnership businesses
    - Even if it is created by another partner, since they are an agent
    - The flipside is that if there are any profits, they are shared equally, even if one partner worked harder (if there is no partnership agreement)
  - All partners are jointly liable (ie can sue one or more, but only one action can be brought) to third parties for breach of contract (s. 13).
    - In a partnership, if any partner incurs a debt in contract, the third party can sue any of them or all of its partners, either way for the whole amount
    - Problematic because if any one enters a contract, they will all be **jointly and personally** liable for breach of that contract
    - That means all the partners' personal assets can be used to pay any debts
  - Liability for tort is joint and several. That is the third party can sue one partner, then another until fully compensated for damages (s. 16).
    - Third party can sue any individual partner for damages
- Advantages of partnerships
  - Flexibility – Since it is a contract, you can make up any rules you want, about the relationship of any of the partners, to suit the type of business arrangement you want
    - No forms need to be lodged – if you want to change anything, just change the contract
  - No external regulation – the Partnership Act does not tell partnerships what to do, it just creates standardised rules to apply if a partnership exists, but if you want to, you can write your own contract with your own rules
  - Privacy – if you create a partnership agreement (contract), the only person who will know what that arrangement is the lawyer
    - Don't need to register that information, no public access to it
  - Tax advantages
  - Trust

- Partnerships generally require trust and a common goal; thus they are common between family (especially husband and wife) and between friends
- Law firms mainly operate as partnerships (only within the last 5 years that they have been able to incorporate and list on the ASX Australian Securities Exchange) because they are not meant to be driven by profit, but from mutual advantage and trust
  - Similarly, with other professions e.g. doctor surgeries, accountants
  - Contrast a company where the directors have to act in the best interest of shareholders, a shareholder acts in the best interests of other partners so there is more trust facilitated as they all have to work together
- Size of a partnership
  - By law, the size of a Partnership is limited to between 2 and 20 partners
  - The exceptions to this are listed in the *Corporations Regulations 2001* (Cth), where a partnership can consist of:
    - 50 actuaries, medical practitioners, patent attorneys, sharebrokers, stockbrokers or trademark attorneys;
    - 100 Architects, pharmaceutical chemists or veterinary surgeons;
    - 400 legal practitioners
    - 1,000 accountants
  - In reality, vast number of businesses that operate are either sole traders or partnerships, but they are very small businesses with the exception of these professional associations

## Company

### *What is the corporation?*

#### **Difference between “Corporation” and “company”**

- In general discussion a “corporation” and a “company” tend to be used interchangeably (as well as “corporate device”)
- S57A: The strict position is that the term “corporation” describes a wider category that includes a company and any body corporate. It also excludes certain types of companies (but includes companies limited by shares, which is relevant for our purposes)
  - So technically a company is one type of a corporation, and corporation has a wider scope of application
  - Body corporate – companies set up by statute
    - Includes: Recognized companies, exempt public authorities, foreign companies or financial institutions

#### **Main characteristics**

- Legal personality
  - The company has a legal existence independent of the people who have established it, invested capital in it, and who are its directors, managers, and employees
  - The company itself has a bundle of legal capacities and obligations– sue and be sued, hold property, enter contracts in its own name
    - S124: The company has the legal capacity and powers of an individual (as well as additional powers of a body corporate listed in s 124)
      - Buy property, pay tax, employ people, sue for defamation
      - Might be subject to things that a company practically cannot do, such as getting married
      - But they may be considered even more powerful than individuals, because of ability to raise funds from the public and their transnational nature
        - At some point in history corporations had more power than women and Indigenous Australians
  - This is the difference between a sole trader and a company that is run by one person (as both the director and shareholder) – there is a legal structure between the person and the outside world
    - This structure means that there is different regulations and obligations that apply than the sole trader who can do anything without regulation
    - This person may have different responsibilities in their two different roles, and the company has its own obligations as well
  - *Queensland Rail* [2015] 256 CLR 15: The defining characteristic of the corporation is its *separateness*
    - Facts:
      - The HC was asked to determine whether Qld Rail, which was a statutory authority created by an Act of Qld Parliament, was a corporation or not for the purposes of s51 (xx) of the Constitution
      - This would determine whether employees of Qld Rail were governed by State or Cth law [industrial dispute case with regards to employment law]

- This is often indicated by the ability to deal with property *in its own name*, enter into legal relationships in its own name, enter contracts, enforce any legal rights it holds in its own name, and perpetual succession
  - Pg 188 [38]: ‘...*the Authority is created as a separate right and duty bearing entity. It may own, possess and deal with real or personal property. It is an entity which is to endure regardless of changes in those natural persons who control its activities and, in that sense, has “perpetual succession”. Its constituting Act provides for mechanisms by which its assumption of rights and duties may be formally recorded and signified. The Authority has “the full character of a corporation”.*’ (Majority, French CJ, Hayne, Kiefel, Bell, Keane and nettle JJ)
  - Pg 199 [67]: ‘*Queensland Rail has legal personality because it is legislatively conferred with capacity to own property, to contract and to sue. It is unnecessary to consider whether any lesser subset of those attributes might suffice to make it a corporation...*’ (Gageler J, in a separate and concurring judgement but agreeing with the majority’s result)
- Note separateness in Solomon v Solomon
- This is an *artificial* legal creation – why did the government allow corporations as a separate legal entity with such significant rights to exist?
  - The company allows economic growth – enabling people to take risks to create new ventures and try out new ideas, which expands new industries, because there is minimal risk in doing it due to limited liability
  - Though in practice, society as a whole may or may not benefit, depending on the nature of the business (generally shareholders benefit because they receive profits and directors because of the increased market to be a good director)
- Limited Liability
  - Directors and shareholders are not personally liable, they are separated and protected from the third parties they deal with in the course of running the business
    - Exception: directors duties
  - This is because the company can enter contracts for the business on their behalf, so it is the one liable for any contract it enters into and any debts that it may incur
    - The company has to pay for the debt through its own assets, may include capital invested by shareholders
      - Since the company has a separate legal personality, the assets that a company has belongs to it, not the shareholders or directors.
      - Shareholders have no legal interest in them, since they belong to the company
  - Even if the shareholder’s capital is not enough to pay off the debt, the shareholders do not have to contribute any more to the company than the amount of shares they agreed to invest (limited to the nominal value of the shares)
    - *Section 516 Corporations Act (CA)* - when a company issues shares, the members are only financially liable to the company to pay the amount (if any) which is unpaid on the shares which they hold
    - If you only partially pay the amount of shares you agree to invest, you are only liable for the amount unpaid on the shares
    - Nominal value of shares is what people buy it for when the company is first listed on the stock exchange and issuing their shares (never changes)
      - Contrast market price of shares, which is the price when the shares get traded later on the stock exchange and often fluctuates (the market value can be much higher or lower than the nominal value)
  - If the company cannot pay off the debt with its assets, that is the death of the company
- Transferable shares – shares are property and can be sold
  - Intangible property – it can thus be traded (bought & sold on the stock exchange marketplace), it can also be left in the will, have money borrowed against it
- Centralized management under a board of directors
  - Division between shareholders (as investors) and board (as managers)
- Shared ownership by contributions of capital
  - Allows diverse contributions of capital
  - They can raise funds from the public (issue shares), borrow money, issue debentures (a form of secured loans)

### Advantages (Broader Benefits)